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(9)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

No. 1312

JOHN A. WATHEN DISTILLERY COMPANY, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

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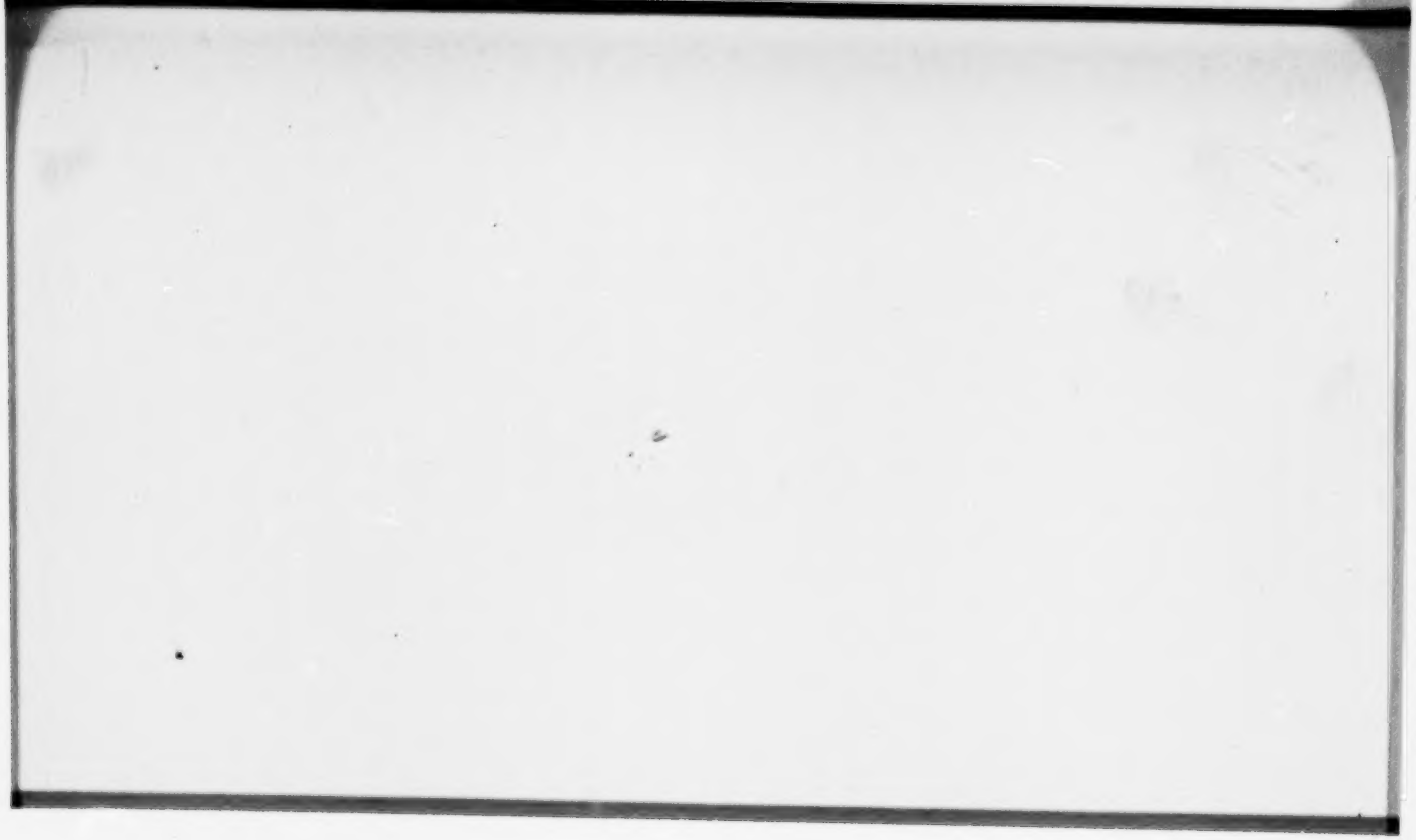

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COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

Your petitioner, John A. Wathen Distillery Company, prays that a Writ of Certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Sixth Circuit entered in the above-entitled cause on February 14, 1945 (R. 93), petition for rehearing (R. 101-142) denied April 3, 1945 (R. 151), reversing a decision of the Tax Court of the United States (R. 81). The Tax Court held that the Commissioner erred in determining against Wathen income tax deficiencies of $100,751.67 for the year 1936 and $37,182.72 for the year 1937 due to imposition of surtaxes on undistributed profits under the Revenue Act of

1936, § 14, when in fact no deficiencies existed because Wathen was entitled to a dividends paid credit under § 26(c)(1) of that Act to the full extent of its undistributed profits.

OPINIONS BELOW.

The opinion of the Tax Court of the United States (R. 68-81) is reported in 1 T. C. 1188. The opinion of the Circuit Court of Appeals (R. 94-100) has not as yet been reported.

JURISDICTION.

The jurisdiction of this Court is invoked under § 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

STATUTES AND REGULATIONS INVOLVED.

Revenue Act of 1936 (49 Stat. at L. 1648), § 26(c)(1) allows a dividends paid credit equivalent to the amount of income which cannot—

> "be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends."

Treasury Regulations 94, Art. 26-2(b) provides that—

> "The credit provided in Section 26(c)(1) is allowable only with respect to a written contract executed by the corporation prior to May 1, 1936, which expressly *deals with the payment of dividends* and *operates as a legal restriction* upon the corporation as to the amounts which it can distribute within the taxable year as dividends." (Italics supplied)

QUESTION PRESENTED.

Whether the Circuit Court erred in reversing the decision of the Tax Court that under § 26(c) (1) Wathen was entitled to a dividends paid credit by virtue of a letter it wrote to

Provident Bank stating that it did not intend to pay any of its surplus to stockholders, that it had no intention of declaring any dividends until its borrowings had been materially reduced, and that it would not declare any dividends while indebted to Provident without first consulting* Provident, which letter was written after Provident advised Wathen that it would not lend Wathen money unless Wathen entered into a written contract with it not to pay any dividends without its permission while indebted to it and which letter both Provident and Wathen considered to be the written contract called for in their negotiations.

SUMMARY STATEMENT.

The Tax Court found the following facts:

(1) On April 28, 1935, Provident Bank advised Wathen that it would lend Wathen money "only if it entered into a written contract with Provident not to pay any dividends without Provident's permission while it owed Provident money." (R. 70)

(2) On April 29, 1935, Wathen wrote and delivered to Provident a letter reading as follows:

> "Confirming conversation held with you with reference to the surplus of this company, wish to state that it is not the intention of the officers or directors of this company to pay any part of this surplus out to the stockholders. We furthermore desire to state that we have no intention of declaring any dividend until such time as the borrowings of this company have been materially reduced. We might also state that we will not declare any dividend in the future while indebted to your bank without first consulting you." (R. 70)

(3) Wathen and Provident "considered this letter to be the required written contract whereby petitioner obligated itself not to pay any dividends while indebted to Provident without first securing the consent of Provident." (R. 71)

---

*For dictionary meanings of "consult" see pages 11 and 12 of this petition.

(4) Wathen "paid no dividends in 1936 or 1937 because it considered it was bound by a written contract with Provident * * * not to pay any dividends without the banks' consent, and in each year the banks had refused their consent." (R. 73)

(5) Wathen's letter "coupled with Provident's acceptance of its terms, followed by the making of loans to petitioner, constituted a written contract executed by petitioner prior to May 1, 1936, which expressly dealt with dividends and prohibited petitioner from the payment of any dividends in 1936 or 1937 without first securing the consent of Provident." (R. 73)

The Tax Court (five judges dissenting) held that Wathen was entitled to the credit. The Tax Court said:

> "Respondent, in his brief, after citing a number of cases holding that the provisions of section 26 (c) (1) must be strictly complied with by the taxpayer corporation to secure the credit therein provided, says:
>
> > * * * From the strict test enunciated in these cases, it would seem that, for the purpose of said section 26 (c) (1), the contract restricting the payment of dividends should be expressly stated therein, that it should be executed by the proper officer of the claimant, attested by the secretary and sealed with the corporate seal. * * *
>
> We agree with all the foregoing requisites except that which says that the written contract must be 'attested by the secretary and sealed with the corporate seal.' There is no such formal requirement to be found in the statute or in the Treasury regulations." (R. 75)
>
> * * * * * * * * *
>
> "We think that this letter, coupled with the circumstances of its delivery to the bank and acceptance by the bank in making its loan, constituted a written contract entered into by petitioner prior to May 1, 1936, which expressly dealt with the payment of dividends and operated as a legal restriction upon petitioner as to the amounts which it could distribute within the two taxable years before us as dividends. We so hold.

This decides the only issue in the case in favor of petitioner." (R. 79)

On review the Circuit Court conceded that

(1) Provident advised Wathen it would make a loan to Wathen "only on condition that it enter into a written contract with Provident not to pay dividends without Provident's permission while it owed Provident money" (R. 94);

(2) Wathen then wrote Provident the letter above set forth (R. 94-95);

(3) "On the strength of this letter Provident extended respondent [Wathen] a $50,000 line of credit" (R. 95);

(4) The foregoing were "essential facts found by the Tax Court and concerning which there is no dispute" (R. 95);

(5) "The promise to consult * * * might reasonably be interpreted, as between respondent and Provident, a promise to declare no dividends without Provident's consent" (R. 97-98); and

(6) "Officers of respondent [Wathen], in addition to officers of Provident, as well as other creditor banks, testified that they regarded such to be the meaning of the agreement to consult." (R. 98)

But the Circuit Court (McAllister, J., dissenting) held that although the letter actually operated between the parties as a legal restriction upon the payment of dividends, nevertheless Wathen was not entitled to a credit under § 26(c)(1), and that the Tax Court erred in resorting to the surrounding circumstances and the intention of the parties in determining the meaning of the contract.

A petition for rehearing was duly filed (R. 107-142) but denied, McAllister, J. again dissenting (R. 151).

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals erred

(1) In disregarding this Court's decision in *Dobson* v. *Commissioner*, 320 U. S. 489, which was urged upon the appellate court below.

(2) In reversing the Tax Court's finding of fact that the words "consulting you" were used in the agreement in the sense of "securing the consent of Provident Bank".

(3) In holding that the Tax Court was obliged to look exclusively to the bare terms of the writing and should not have considered testimony concerning the intent of the contracting parties and the circumstances surrounding the execution of the agreement in determining in which of its several equally well recognized meanings the word "consulting" was used in the agreement.

(4) In deciding that the Tax Court erred in holding that the letter from Wathen to Provident constituted a written contract which expressly dealt with and prohibited Wathen from paying dividends without first securing Provident's consent.

REASONS FOR GRANTING THE WRIT.

1. *The reversal by the Circuit Court of the decision of the Tax Court conflicts with the principles announced by this Court in Dobson v. Commissioner, 320 U. S. 489.*

The Tax Court found as a fact that the words "consulting you", as used in the Wathen-Provident agreement, had the meaning of "securing the consent of Provident." (R. 73)

The Tax Court held that it should consider the intent of the contracting parties and the circumstances surrounding the execution of the writing when deciding in which of its recognized senses the word "consulting" was used in the agreement. (R. 77)

And, as hereinbefore stated, the Tax Court found that:

> "Petitioner's letter to Provident, dated April 29, 1935, coupled with Provident's acceptance of its terms, followed by the making of loans to petitioner, constituted a written contract executed by petitioner prior to May 1, 1936, which expressly dealt with dividends and prohibited petitioner from the payment of any dividends in 1936 or 1937 without first securing the consent of Provident." (R. 73)

The essential facts were admittedly correctly found by the Tax Court (R. 95). The inferences from them were likewise correctly determined by the Tax Court.

Certainly, the Circuit Court did not separate the elements of the decision so as to identify a clear-cut mistake of law. The Tax Court's decision had warrant in the record, a rational basis in the law, and the judicial function was exhausted. *Dobson* v. *Commissioner*, 320 U. S. 489, 501, 502.

The Tax Court has the primary function of finding the facts in tax disputes, weighing the evidence and choosing from among conflicting factual inferences and conclusions those which it considers most reasonable. The appellate courts have no power to change or add to those findings of fact or to reweigh the evidence. When the Tax Court's factual inferences and conclusions are determinative of compliance with statutory requirements, the appellate courts are limited to a determination of whether they have any substantial basis in the evidence. The skilled judgment of the Tax Court, which is the basic fact-finding and inference-making body, must thus be given wide range in such proceedings. *Commissioner* v. *Scottish American Investment Co., Ltd.*, 323 U. S. 119 (1944); see also *Commissioner* v. *Court Holding Co.*, 324 U. S. .... (1945).

To permit the Circuit Courts to reverse the Tax Court in cases like the instant one would require this Court to enter into a quagmire of particularities and to make detailed analyses of the special circumstances of all contracts of this sort, involved not only in § 27(c)(1) but in analo-

gous situations under the income taxing acts. *McDonald* v. *Commissioner*, 323 U. S. 57 (1944).

2. *The decision of the Circuit Court is in conflict with the decision of the Court of Claims in Rex-Hanover Mills Co. v. United States, 53 F. Supp. 235 (1944), with the decisions of the 8th Circuit in United States v. Dakota Tractor & Equipment Co., 125 F. (2d) 20 (1942) and Harding Glass Co. v. Commissioner, 142 F. (2d) 41 (1944), and with the decisions of the Sixth Circuit itself in Glenn v. Chess & Wymond, 132 F. (2d) 621 (1942) and Automotive Parts Co. v. Commissioner, 134 F. (2d) 420 (1943).*

In this Wathen case the Circuit Court held that, in determining the meaning the word "consulting" bore in the agreement, the Tax Court could not consider the circumstances surrounding the execution of the agreement or evidence of the intent of the contracting parties.

In the *Rex-Hanover Mills* case, *supra*, the allowance of the dividends paid credit turned on the question whether or not the words "surplus" and "net profits", used in the contract, were meant to include certain earnings of earlier years which had been capitalized by stock dividends. As between two possible meanings, the Court of Claims decided that the real meaning was to exclude such earnings. It based that finding on the conduct of the parties and on other circumstances extraneous to the wording of the contract. The Court allowed the credit notwithstanding the fact that the bare words needed explanation from surrounding circumstances.

In the *Dakota Tractor & Equipment Co.* case, *supra*, the Court resorted to extraneous circumstances in determining whether certain statements in the letter relied upon were intended to operate as a binding promise, satisfying § 26(c)(1), or were merely statements of business policy as was contended by the Government. The Court said (125 F. (2d), at p. 24):

> "Appellant contends the letter is not a statement of the terms of a unilateral contract but is merely a statement of 'business policy' which appellee intended to pursue. It seems clear that the letter is a statement of the terms of a proposed unilateral contract which became binding when the later contract* was executed. Both the testimony as to what brought about the letter and also the terms of the letter itself are convincing."

In the *Harding Glass* case, two writings were relied upon as constituting contracts prohibiting the payment of dividends. One of the writings required that all of Harding's surplus and earnings should be used for plant expansion or for the payment of specified obligations, but did not in terms refer to the non-payment of dividends. The other writing was a letter from Harding to its stockholder, Fourco Glass Co., which stated:

> "We agree to the conditions stated in a loan agreement made of even date * * * between you and the Diamond Alkali Co."

The loan agreement referred to provided that Fourco would not permit Harding to pay dividends while Fourco was indebted to Diamond; it was not executed by Harding.

The Eighth Circuit held that each of the instruments executed by Harding constituted a written contract expressly dealing with and prohibiting the payment of dividends, although neither of them contained any reference to dividends and one of them merely agreed to the unspecified terms of a wholly separate instrument.

In the *Chess & Wymond* case, a bank wrote Chess & Wymond, which was seeking a line of credit (40 F. Supp., at p. 668):

> "We understand that you feel obligated to declare and pay preferred dividends on your new issue, requiring $28,000 per year. While we feel that it is wrong in principle for stockholders to withdraw money from this

* Agency contract containing no reference to dividends.

company in view of its present need, the amount is relatively small in relation to the contemplated earnings. We would definitely oppose the payment of such dividends, however, should the earnings fall under $30,000 per quarter."

Chess & Wymond replied (40 F. Supp., at p. 668):

"Thanks very much for your letter of December 18 which will be very helpful and is greatly appreciated."

A loan was made by the bank.

The Sixth Circuit affirmed (132 F. (2d) 621) the decision of the District Court which had held that these letters, indefinite as they were, should be construed in view of the "intention of the contracting parties" (40 F. Supp., at p. 670) and the "subsequent conduct of the parties" (40 F. Supp., at p. 671), that such intention was "controlling in the decision of this case" (40 F. Supp., at p. 670), and that, therefore, Chess & Wymond was entitled to a credit under § 26(c)(1).

In this Wathen case the Circuit Court sought to distinguish its decision in the *Chess & Wymond* case by merely saying:

"The Tax Court relied on *Glenn, Collector, v. Chess & Wymond*, 132 F. (2d) 621 (C. C. A. 6). From our viewpoint that case does not sustain respondent's contention. The facts in that case show that there was an exchange of letters* (40 F. Supp. 666); and this court held that the letters resulted in a written contract expressly dealing with the payment of dividends. Our decision therein was based upon the contract and not upon extraneous considerations." (R. 100)

In the *Automotive Parts Co.* case, *supra*, the creditor telegraphed Automotive that it felt Automotive's creditors

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* If by emphasizing "exchange of letters" the Court meant to hold that a unilateral contract—a written promise signed by the taxpayer and acted upon by the making of a loan—is not sufficient under § 26(c)(1), the decision conflicts with *United States* v. *Hillcrest Investment Co.*, 147 F. (2d) 194 (C. C. A. 8th, 1945).

should have the protection of a provision regarding dividends. Automotive's President replied that he would be willing to enter into any reasonable agreement concerning dividends, but looked to dividends in the sum of $6,000 a year to liquidate an existing personal obligation of his. The creditor then wrote back:

> "We understand the situation regarding dividends and are entirely satisfied." (134 F. (2d), at p. 421)

A loan was made.

The Sixth Circuit held that this exchange of letters and telegrams constituted a contract expressly dealing with and operating as a restriction on the payment of dividends and that Automotive was therefore entitled to a dividends paid credit.

3. *The decision of the Circuit Court in the instant case is so patently erroneous as to call for an exercise of this Court's power of supervision.*

The Circuit Court said:

> "There is no suggestion that consulting implies obtaining consent." (R. 99)

The Court apparently overlooked the fact that all standard dictionaries establish that the word "consult" means "to apply for instruction", i.e., "to apply for an authoritative command * * * or order intended as a rule of action or conduct."

Webster's New International Dictionary, 2d Edition, defines "consult" as meaning "to apply for * * * instruction * * *". That dictionary defines "instruction" as "that which is given by way of direction or command, orders, esp. as to duty or procedure; as, instructions to a jury; instructions to a servant". That dictionary also defines "instruction" as "a precept", and defines "precept" as "an authoritative command; order; mandate * * * any commandment, instruction or order intended as a rule of action or conduct * * *".

Funk & Wagnalls New Standard Dictionary of the English Language defines "consult" as "to apply to for direction * * * to ask advice or direction from another". It then defines "direction" as "instruction how to proceed; command; order".

The *Century Dictionary and Cyclopedia* defines "consult" as "have recourse to for information or instruction". It defines "instruction" as "direction given; order; command; mandate."

It is thus seen that the bare words of the Wathen letter, without recourse to any outside circumstances or evidence of the intent of the contracting parties, in terms require Provident's consent to any payment of dividends.*

The Circuit Court apparently did not realize this and felt that the word "consult" standing alone could not mean "obtain consent".

The Circuit Court then held that in deciding whether a writing entitles a taxpayer to a credit under § 26(c)(1) it is not proper to construe the words of that writing in view of the circumstances surrounding its execution and the intent of the contracting parties, but that the court must look at the bare words standing alone as if in a vacuum. The Court gave no weight to the fact that the Wathen-Provident contract was drafted by businessmen in business surroundings before the enactment of the provision being construed. See *Rex-Hanover Mills Co.* v. *United States*, 53 F. Supp. 235, 246 (Ct. Cls., 1944).

In fact, the statute and the regulations do not require that a contract contain exact technical terms having only one meaning which, remote from human affairs, expressly prohibit the payment of dividends. They merely require that such a contract when construed according to ordinary rules of contract construction shall "operate as a legal restriction" upon the payment of dividends. Reg. 94, Art. 26-2(b).

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* In *Colyar* v. *Wheeler*, 110 Tenn. 58, 75 S. W. 1089, it was held that the words "upon consultation and getting advice from said trustee" meant "with the consent of the trustee."

The result arrived at by the Circuit Court is contrary to the intent of Congress. This high-rate surtax was enacted to combat a method of evading existing surtaxes by which stockholders with large incomes saw to it that corporations unreasonably accumulated profits so as to save the stockholders from having to pay income tax on dividends. Explaining why the provisions for credits were necessary, the Ways and Means Committee said, "It has been recognized that in certain cases corporations cannot pay out dividends or that sound policy demands the non-payment of dividends." 74th Cong., 2d Sess., Rep. No. 2475, p. 8. See also Senate Finance Committee, Rep. No. 2156, 74th Cong., 2d Sess., p. 12. The present case is one, as the Circuit Court admits, where the corporation was bound not to declare a dividend. It is one of the cases Congress intended to relieve.

CONCLUSION.

Wherefore, it is respectfully submitted that this petition for a writ of certiorari to review the judgment of the Circuit Court of Appeals for the Sixth Circuit should be granted.

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May, 1945.

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BRIEF FOR THE RESPONDENT IN OPPOSITION

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Statutes:

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The opinion of the Tax Court (R. 68–81) is reported in 1 T. C. 1188. The opinion of the circuit court of appeals (R. 94–100) is reported in 147 F. 2d 998.

JURISDICTION

The judgment of the circuit court of appeals was entered on February 14, 1945 (R. 93). A petition for a rehearing was filed by the taxpayer on March 2, 1945, and was denied by the circuit court of appeals on April 3, 1945 (R. 101, 151). The petition for a writ of certiorari was filed on May 25, 1945. Jurisdiction of this Court

is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the circuit court of appeals erred in holding that the taxpayer was under no written contract which prohibited the payment of dividends within the meaning of Section 26 (c) (1) of the Revenue Act of 1936, and was therefore not entitled to a credit thereunder for the years 1936 and 1937 for the purposes of the surtax on undistributed profits imposed by Section 14 of that Act.

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 14. SURTAX ON UNDISTRIBUTED PROFITS.

(a) *Definitions.*—As used in this title—

(1) The term "adjusted net income" means the net income minus the sum of—

(A) The normal tax imposed by section 13.

* * * * *

(2) The term "undistributed net income" means the adjusted net income minus the sum of the dividends paid credit provided in section 27 and the credit provided in section 26 (c), relating to contracts restricting dividends.

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corpo-

ration a surtax equal to the sum of the following, subject to the application of the specific credit as provided in subsection (c):

* * * * *

SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * *

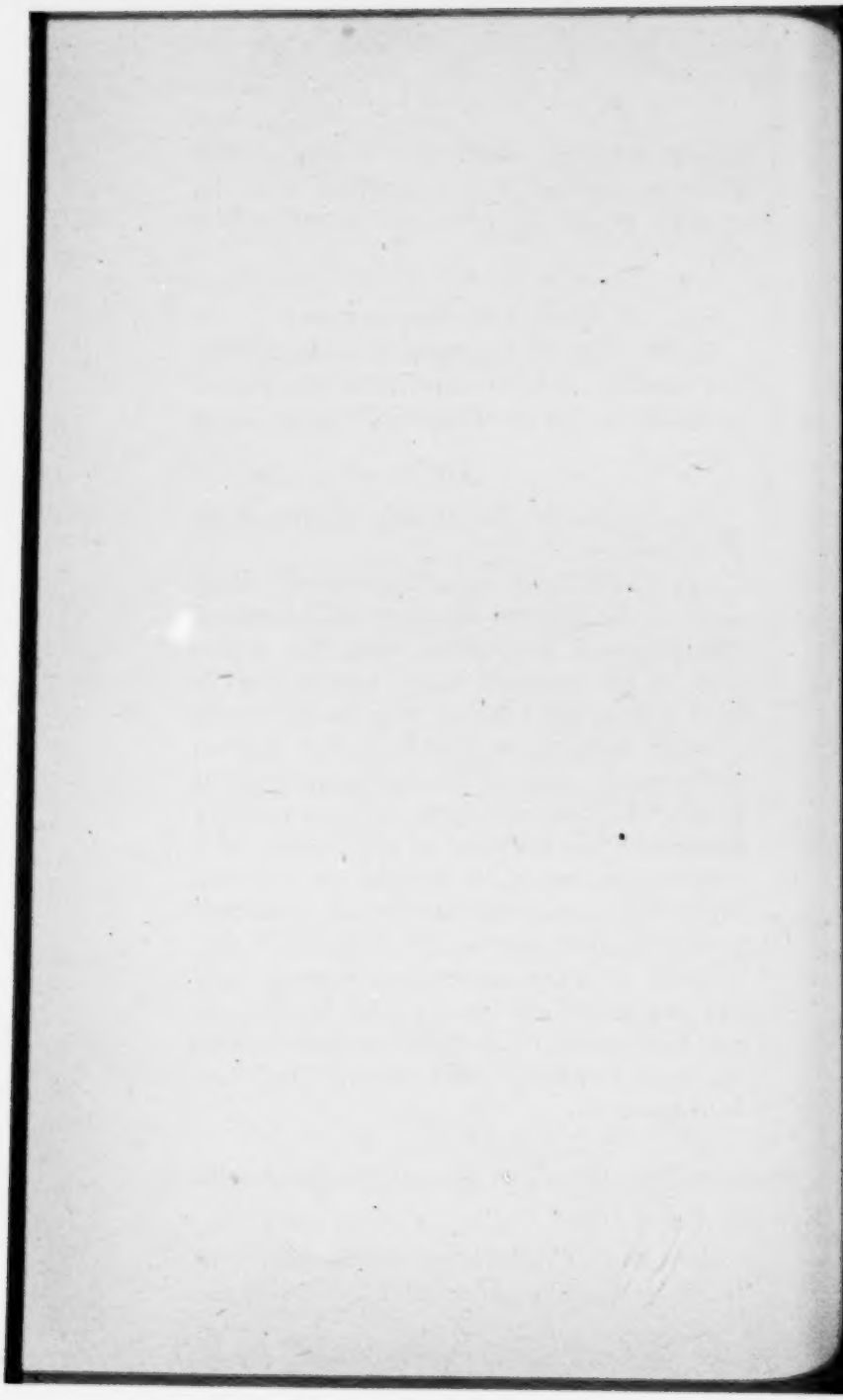
(c) *Contracts Restricting Payment of Dividends.*—

(1) *Prohibition on Payment of Dividends.*—An amount equal to the excess of the adjusted net income over the aggregate of the amounts which can be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends. If a corporation would be entitled to a credit under this paragraph because of a contract provision and also to one or more credits because of other contract provisions, only the largest of such credits shall be allowed, and for such purpose if two or more credits are equal in amount only one shall be taken into account.

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 26–2. *Credit in connection with contracts restricting payment of dividends.*—



(*a*) The credit provided in section 26 (c) with respect to contracts restricting the payment of dividends is not available under every contract which might operate to restrict the payment of dividends, but only with respect to those provisions of written contracts executed by the corporation prior to May 1, 1936, which satisfy the conditions prescribed in the Act. The charter of a corporation does not constitute a written contract executed by the corporation within the meaning of section 26 (c). The provisions recognized by the Act are of two general types, as follows:

(1) Those which come within section 26 (c) (1), in that they prohibit or limit the payment of dividends during the taxable year; and

* * * * *

(*b*) *Prohibition on payment of dividends.*—The credit provided in section 26 (c) (1) is allowable only with respect to a written contract executed by the corporation prior to May 1, 1936, which expressly deals with the payment of dividends and operates as a legal restriction upon the corporation as to the amounts which it can distribute within the taxable year as dividends. * * *

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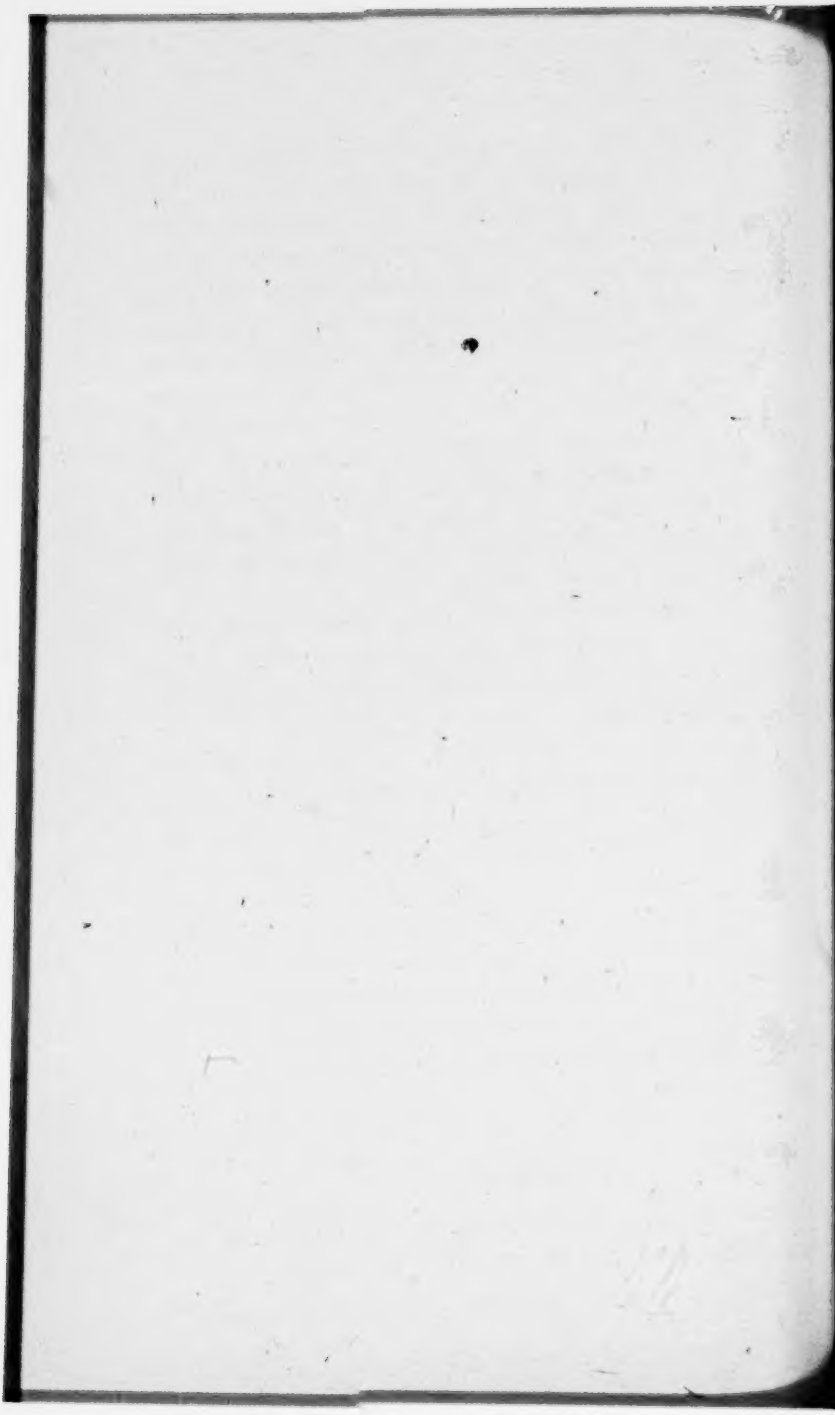
STATEMENT

The following material facts are contained in the findings of the Tax Court (R. 69–73):

The taxpayer is a Missouri corporation engaged

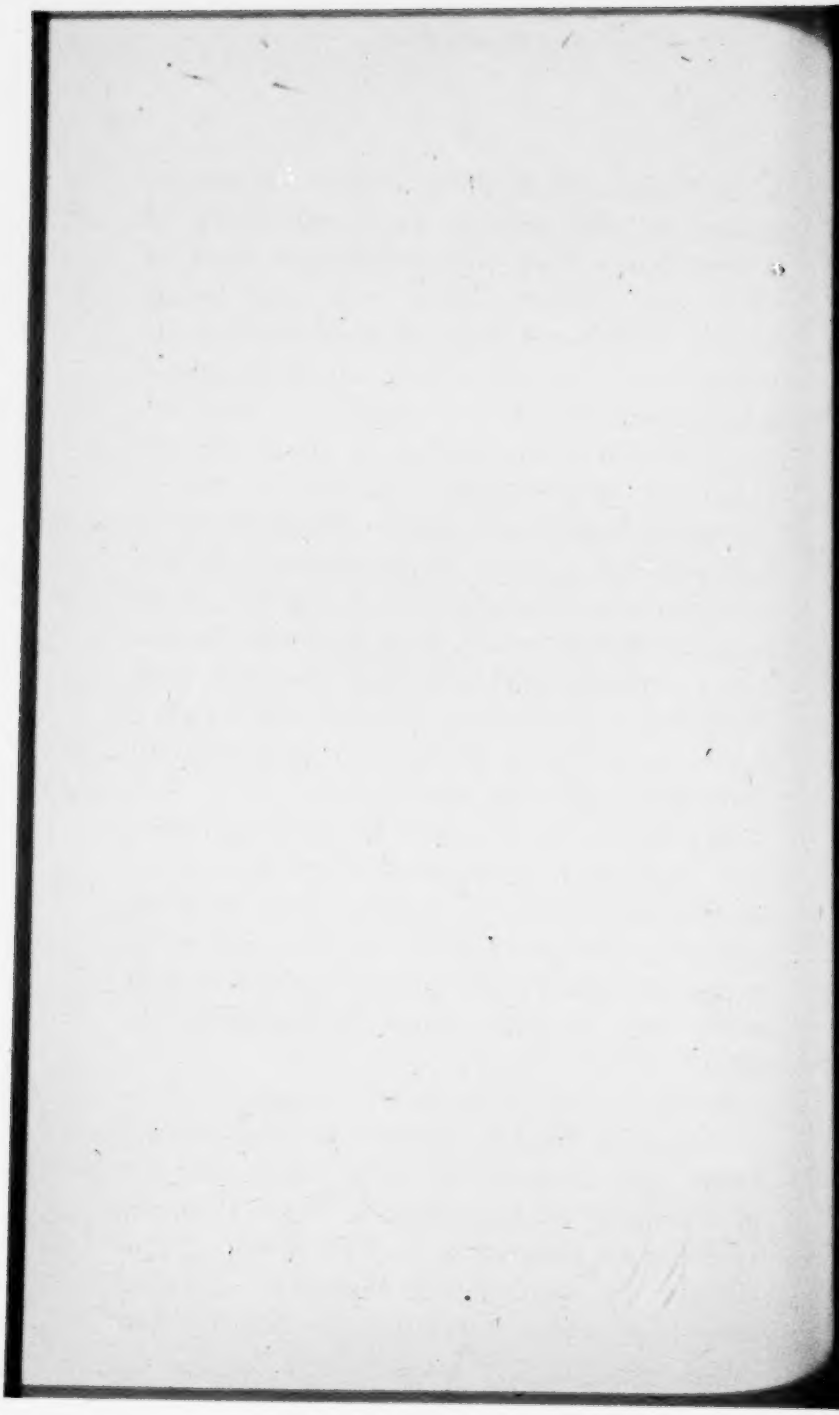


in the business of distilling whiskey. It was organized in 1933 with an authorized capital of 200,000 shares of $1 par value common stock, of which only 125,000 shares were ever issued. These 125,000 shares were sold for a distillery site and $115,000 cash, which lacked about $25,000 of being enough to pay for taxpayer's small 30-barrel-a-day distillery and one warehouse at a cost of approximately $145,000. (R. 69.)

From the beginning taxpayer required the use of bank credit in carrying on its business. As fast as it improved its credit position and was able to borrow sufficient money from the banks its distillery capacity was successively increased from 30 barrels a day in May, 1934, to 210 barrels a day in May, 1936, at which rate it operated until November, 1937. (R. 69.)

As a result of large outlays for plant expansion, large increases in daily operating cost through increased production, its whiskey aging program, and other business reasons, the taxpayer in the spring of 1935 needed a greater amount of bank credit than it could obtain in Louisville (R. 69–70).

In April, 1935, A. J. Harris, taxpayer's president, and Ben Kaplan, a director of taxpayer, conferred with the president and assistant treasurer of Provident Savings Bank & Trust Company (hereinafter referred to as Provident) of Cincinnati. In examining the taxpayer's statement these bank officers noted that the taxpayer had

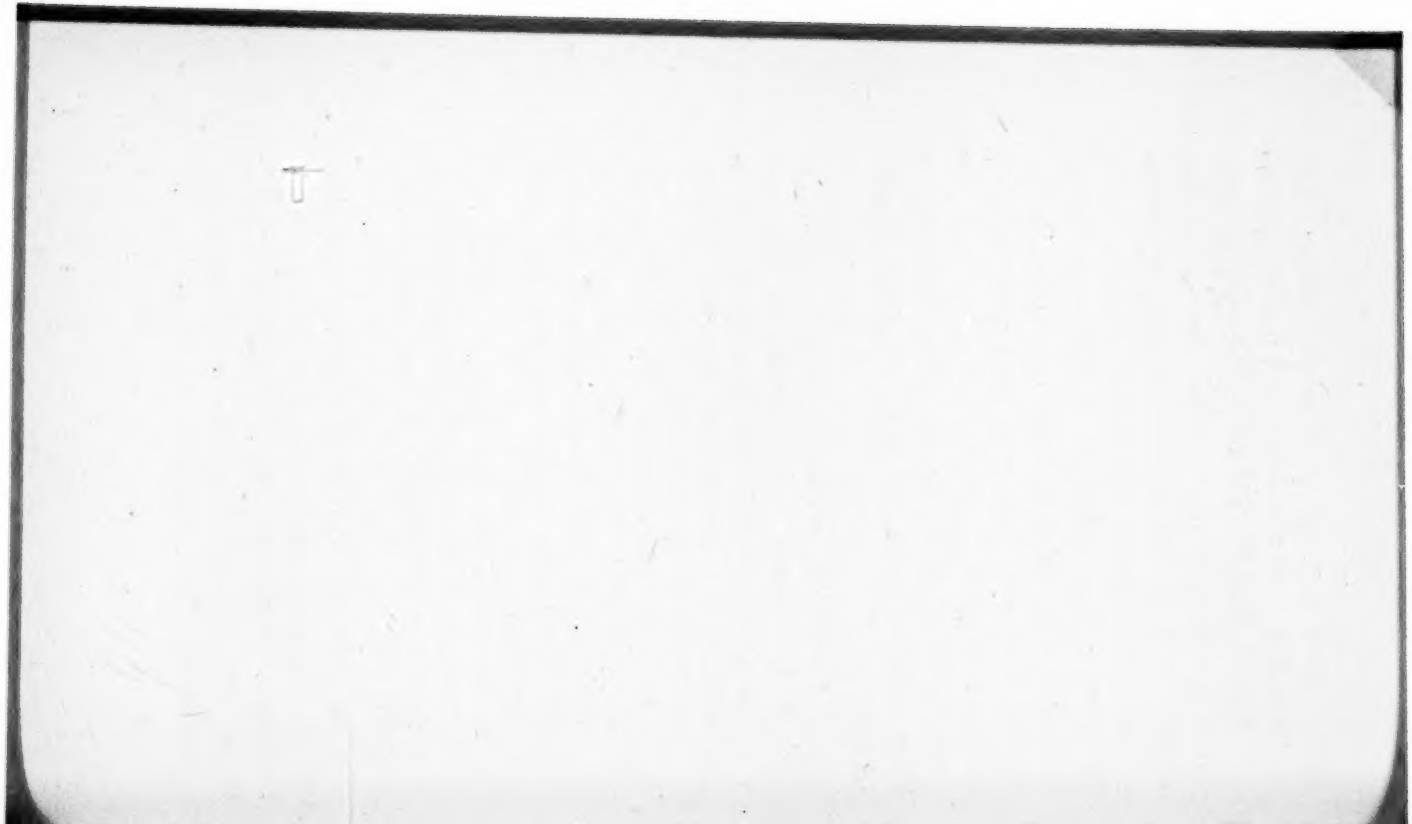


paid a small dividend in December, 1934. They felt this had been a mistake and advised Harris and Kaplan that Provident would lend the taxpayer money only if it entered into a written contract with Provident not to pay any dividends without Provident's permission while it owed Provident money. Harris and Kaplan returned to Louisville and talked to their associates in the Wathen Company, who consented that such an agreement be signed. (R. 70).

On April 29, 1935, Harris wrote Provident a letter, relevant parts of which read as follows (R.70):

> Confirming conversation held with you with reference to the surplus of this company, wish to state that it is not the intention of the officers and directors of this company to pay any part of this surplus out to the stockholders. We furthermore, desire to state that we have no intention of declaring any dividend until such time as the borrowings of this company have been materially reduced.
>
> We might also state that we will not declare any dividend in the future, while indebted to your bank, without first consulting you.

On the same day Harris and Kaplan took this letter to Cincinnati and personally delivered it to Provident. Provident extended taxpayer a $50,000 line of credit and loaned the taxpayer $25,000 at that time. The taxpayer and Provident con-



sidered this letter to be the required written contract whereby the taxpayer obligated itself not to pay any dividends while indebted to Provident without first securing the consent of Provident, and they so treated it throughout the years 1935, 1936 and 1937. This $50,000 credit was far from being sufficient to meet the taxpayer's needs. (R. 70–71.)

Several other banks, advised of the above letter, subsequently made loans to taxpayer on the oral understanding that taxpayer would not pay any dividends while indebted to them without their prior consent and that the taxpayer would not prefer any of the banks over the others in either borrowings or payments and that each should participate proportionately (R. 71).

During the taxable years 1936 and 1937 here in question, taxpayer's lines of credit were constantly being used and it never had any large amounts of cash on hand (R. 72).

During 1936 the most cash that taxpayer had on hand on any one day was $47,476.33; its lowest indebtedness to Provident was $66,797.93; and its lowest indebtedness to the other banks was $287,928.12 (R. 72).

During 1937 the most cash that taxpayer had on hand on any one day was $76,872.34; its lowest indebtedness to Provident was ~~$66,797.93~~ $63,004.80; and its lowest indebtedness to the other banks was $341,075.04 (R. 72).

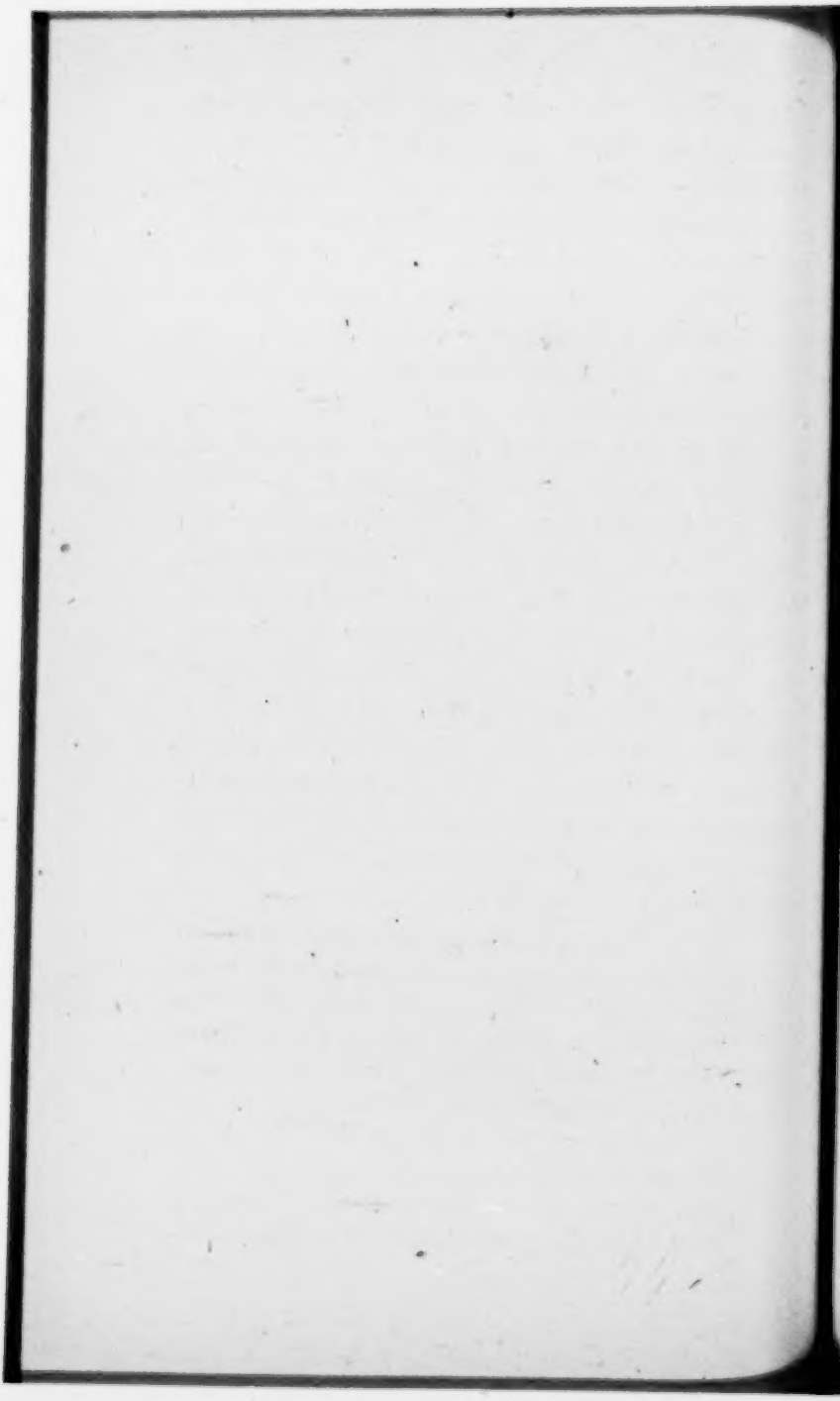
After April 29, 1935, when taxpayer wrote Provident the letter quoted above and Provident extended the $50,000 line of credit, taxpayer continuously remained indebted to Provident throughout the remainder of the year 1935 and all of the years 1936 and 1937. Taxpayer's indebtedness to Provident was not fully paid until 1940. (R. 72.)

Taxpayer gave Provident and the other banks participating in the lines of credit notes payable in three months, instead of long-term notes, as the banks wanted short-term notes so as to be able to rediscount them with the Federal Reserve Bank. But the credit lines were established with the understanding that taxpayer would need the money for a long time and that these three-month notes would not be paid off at maturity but would be renewed from time to time. (R. 72.)

On December 16, 1936, taxpayer wrote each of its banks substantially identical letters requesting permission to pay a dividend (R. 72).

Its letter to Provident, omitting formal parts, was as follows (R. 72–73):

> * * * this company will earn for the 12 months' period ending December 31, 1936, approximately $550,000.00 net, after depreciation, reserves for taxes, etc. Therefore, the management is favoring the payment of a dividend to stockholders.
>
> In view of the fact that our Mr. A. J. Harris wrote you under date April 29, 1935, that we would not pay a dividend so long as this company was indebted to your insti-



> tution, without first receiving your approval, we are, therefore, asking that you give careful consideration to this matter and advise us of your reaction.

On December 19, 1936, Provident replied (R. 73):

> After giving this matter careful consideration, we cannot permit the payment of a dividend at this time which would be in violation of an agreement entered into by the officers of your company under date of April 29, 1935. They agreed they would not pay a dividend as long as your company was indebted to our bank. The payment of a dividend at this time would decrease your working capital and work a hardship on the operation of your business.

The other banks to which taxpayer was indebted replied in a similar vein to taxpayer's letter of December 16, 1936, and refused taxpayer's request for permission to pay a dividend to its stockholders at the end of 1936 (R. 73).

In December, 1937, taxpayer again ~~requested~~ asked the banks to which it was indebted for permission to declare and pay a dividend to its stockholders at the close of 1937. This time the request was oral. Each of the banks again refused to give its consent to the payment of any dividends. (R. 73.)

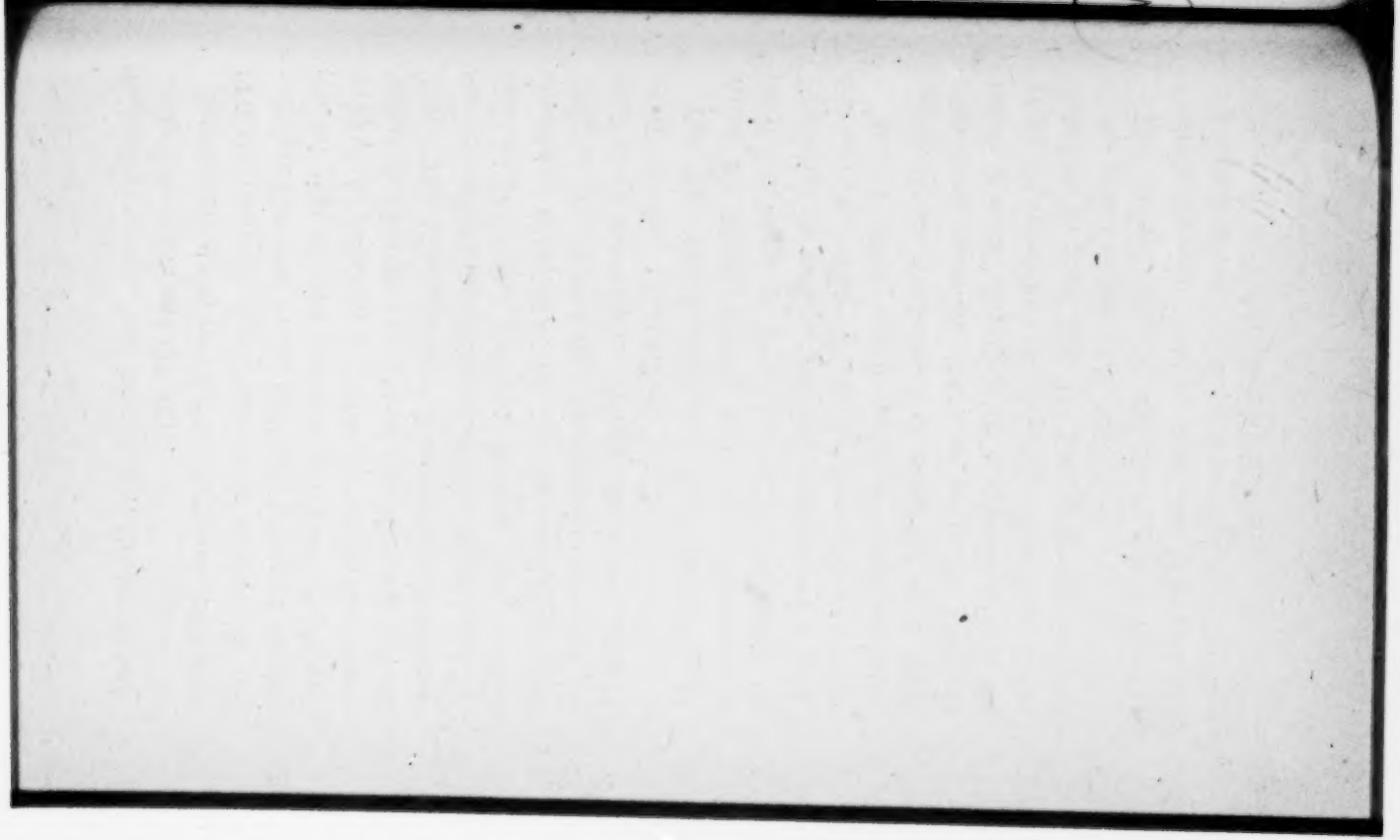
Taxpayer paid no dividends in either 1936 or 1937 because it considered ~~it was~~ itself bound by a written contract with Provident, verbally extended to the other banks, not to pay any dividends without

the banks' consent, and in each year the banks had refused their consent (R. 73).

In its income tax returns for the years 1936 and 1937 the taxpayer claimed a credit against its adjusted net income to the full extent thereof on the ground that it was under a contract which restricted the payment of dividends within the meaning of Section 26 (c) (1) of the Revenue Act of 1936. The Commissioner determined deficiencies for surtax on undistributed profits as provided by Section 14 of the Revenue Act of 1936, in the amount of $100,751.67 for 1936 and $37,182.72 for 1937, on the ground that the taxpayer was not restricted by any written contract from the payment of dividends. (R. 10–14).

The Tax Court concluded that the letter of April 29, 1935, coupled with the circumstances of its delivery to Provident and acceptance by Provident in making its loan, constituted a written contract entered into by the taxpayer prior to May 1, 1936, which expressly dealt with the payment of dividends and operated as a legal restriction upon the taxpayer as to the amounts which it could distribute as dividends within the years in question (R. 78–79). The Tax Court therefore decided that the taxpayer was entitled to the credit claimed (R. 81).

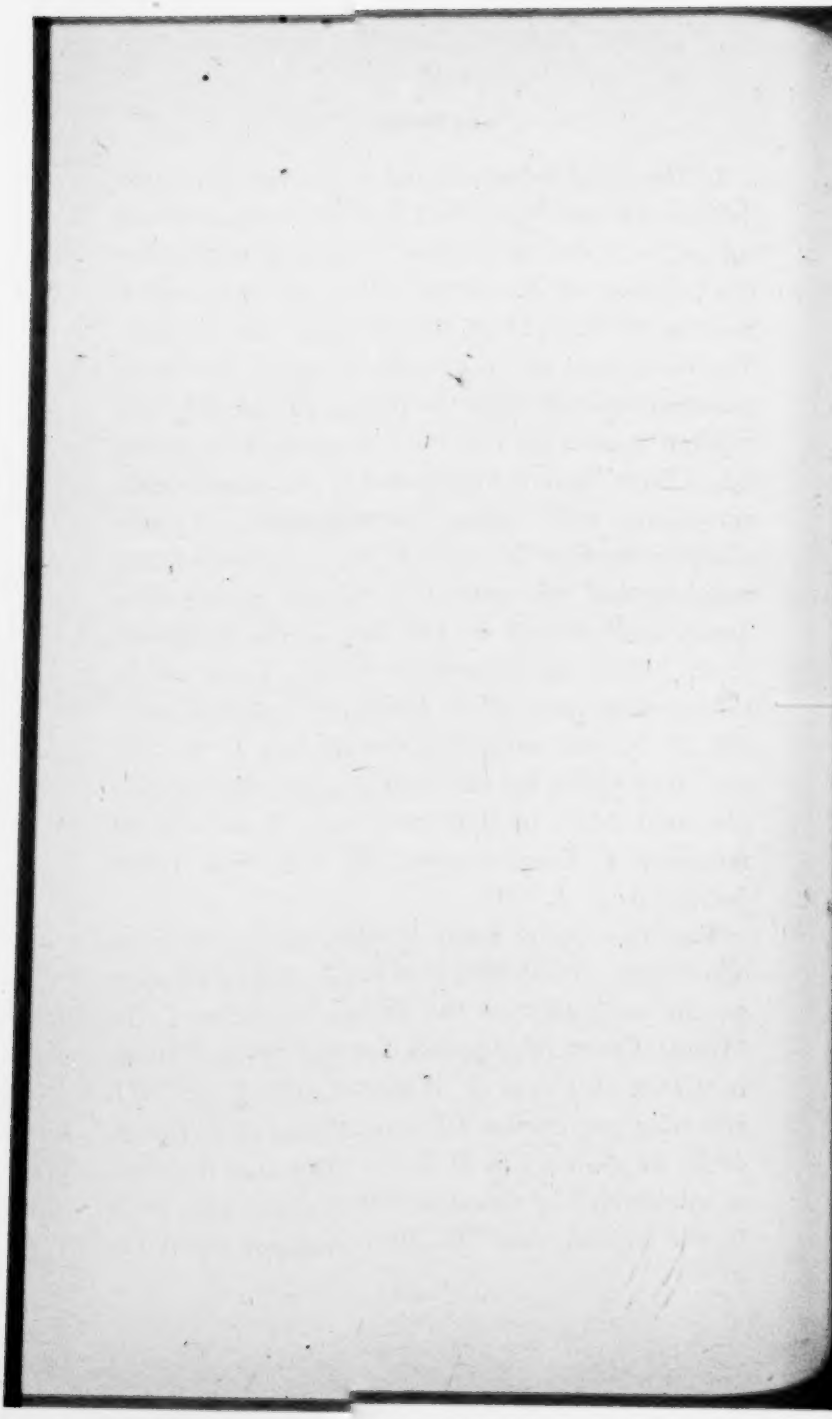
The circuit court of appeals reversed the Tax Court's decision, holding that the taxpayer had not executed a written contract which prohibited it from declaring dividends (R. 100).



ARGUMENT

1. The court below did not err in reviewing the decision of the Tax Court that the taxpayer was subject to a written contract expressly restricting the payment of dividends within the meaning of Section 26 (c) (1) of the Revenue Act of 1936. The facts were not in dispute (R. 95). The basic question was not what the parties intended by the written document, nor even what their intention might have been as manifested by extraneous conversations and other circumstances; it was whether Section 26 (c) (1) as a matter of law requires that the restriction against paying dividends shall appear on the face of the document itself. This was a question of law, quite unlike the question involved in *Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231, and reviewable by the courts under the principles laid down in that case. See *Trust u/w of Bingham* v. *Commissioner,* No. 932, this Term, decided June 4, 1945.

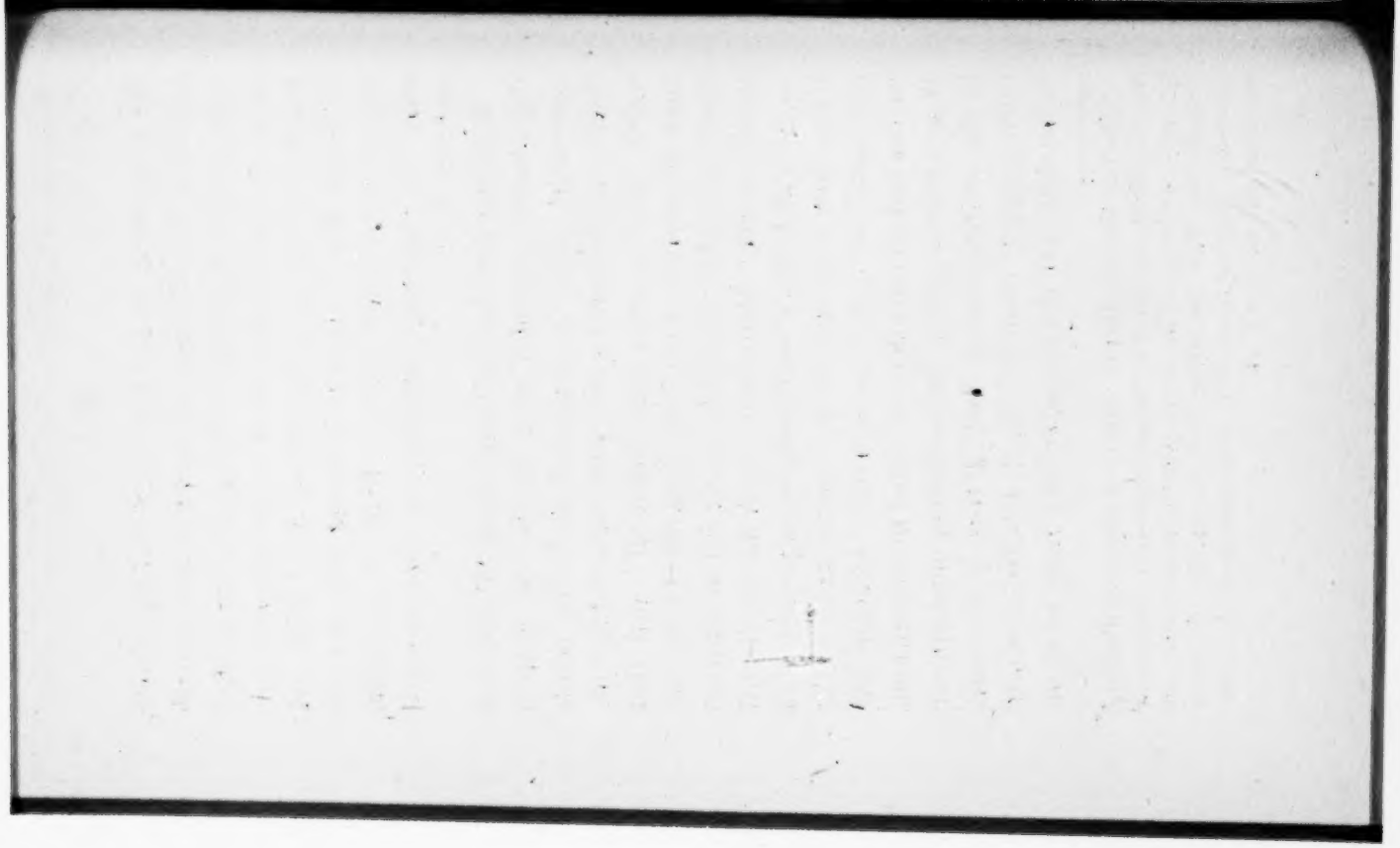
The Tax Court itself treated the question as one of law. It decided it in favor of the taxpayer on the authority of the earlier decision of the Circuit Court of Appeals for the Sixth Circuit in *Glenn* v. *Chess & Wymond,* 132 F. 2d 621, affirming *per curiam Chess & Wymond* v. *Glenn,* 40 F. Supp. 666 (E. D. Ky.). But that decision, as interpreted by the same circuit court of appeals in the instant case (R. 100), did not stand for



the proposition of law for which the Tax Court had cited it,[1] and was as a matter of law inapplicable in the instant case. The court below applied the correct rule of law, which is that stated by this Court in *Helvering* v. *Northwest Steel Mills*, 311 U. S. 46, 49: "Congress indicated that any exempted prohibition against dividend payments must be expressly written in the executed contract."

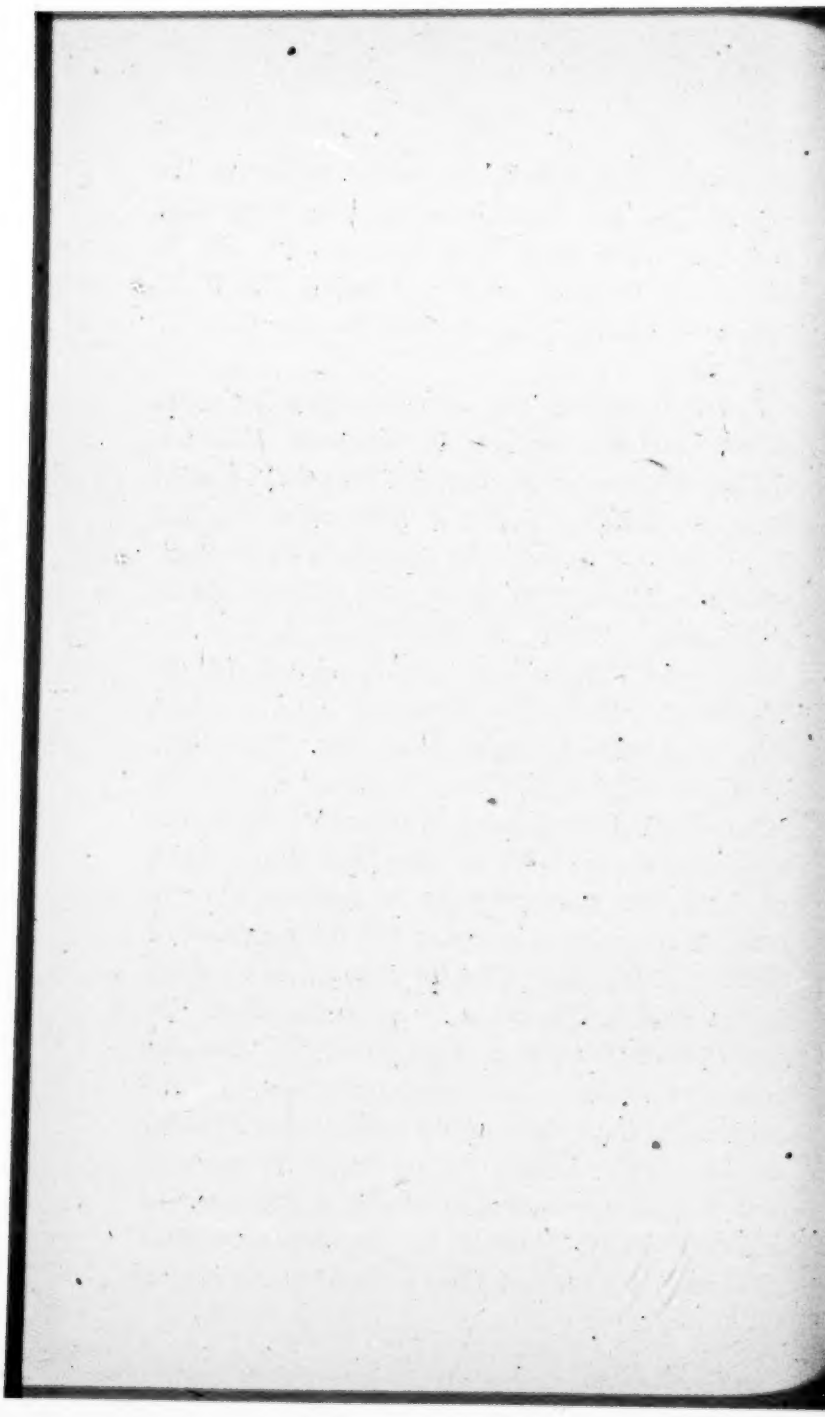
It is true that the Tax Court stated (R. 76) that the question depended upon whether the written agreement might be construed as if the words "without consulting you" were followed by the words "and securing your approval", and that from the conduct of the taxpayer's officers the Tax Court concluded that the taxpayer did so construe the agreement. But this approach was predicated on the Tax Court's legally erroneous premise that it was free to go outside the express terms of the agreement in order to ascertain whether the parties had an intention not stated in the contract. If as a matter of law the restriction must appear in the written contract itself, it was, as the court below properly observed (R. 98, 99–100), entirely immaterial that the taxpayer may have acted on

[1] The fact that the district court in the *Chess & Wymond* case may have considered extraneous matters in arriving at the same conclusion as the circuit court of appeals does not alter the fact that the latter court, in reaching the same conclusion, properly limited its consideration to the documents themselves. See R. 100.



the assumption that it was bound to secure the approval of the bank before paying dividends. *Helvering* v. *Magnus Beck Brewing Co.* 132 F. 2d 379 (C. C. A. 2), certiorari denied, 319 U. S. 749; see also *Helvering* v. *Ohio Leather Co.*, 317 U. S. 102.

2. The taxpayer (Pet. 8) relies upon five cases as establishing a conflict: *Rex-Hanover Mills Co.* v. *United States*, 53 F. Supp. 235 (C. Cl.); *United States* v. *Dakota Tractor & Equipment Co.*, 125 F. 2d 20 (C. C. A. 8); *Harding Glass Co.* v. *Commissioner*, 142 F. 2d 41 (C. C. A. 8); *Glenn* v. *Chess & Wymond*, 132 F. 2d 621 (C. C. A. 6); and *Automotive Parts Co.* v. *Commissioner*, 134 F. 2d 420 (C. C. A. 6). However, none of these cases establishes the asserted conflict. The *Chess & Wymond* case has been discussed above; the other Sixth Circuit case, *Automotive Parts Co.* v. *Commissioner*, holds no more than that a series of documents may properly be read together to constitute a written contract for the purposes of Section 26 (c) (1). The *Harding Glass Co.* case, in the Eighth Circuit, is to the same effect. In the *Dakota Tractor & Equipment Co.* case the court examined extrinsic conversations not for the purpose of implementing the contract but in order to determine whether the document in question was a binding contract or merely a statement of business policy. And in the *Rex-Hanover Mills Co.* case the Court of Claims declined the invita-



tion of the Government to consider extraneous events for the purpose of giving to the contract a construction contrary to its normal and apparent meaning.

Moreover, it is to be noted that two of these cases—the *Harding Glass Co.* and *Automotive Parts Co.* cases—arose from the Tax Court, and in each the court treated the Tax Court's decision on the application of Section 26 (c) (1) to the alleged contract as a reviewable decision on a qvestion of law.[2]

3. This case raises no question of importance in the administration of the tax laws. Since the provisions of the Revenue Act of 1936 relating to the taxation of undistributed earnings and profits were not continued in subsequent revenue acts, cases involving Section 26 (c) (1) can arise only with respect to returns filed for the years 1936 and 1937. There is no merit in the taxpayer's contention that the court below gave a "patently erroneous" meaning to the word "consult" as used in the particular contract here involved; but even were it arguable that the court below was in error in this respect, the correctness of its decision on so particularized an issue presents no ground for review by this Court.

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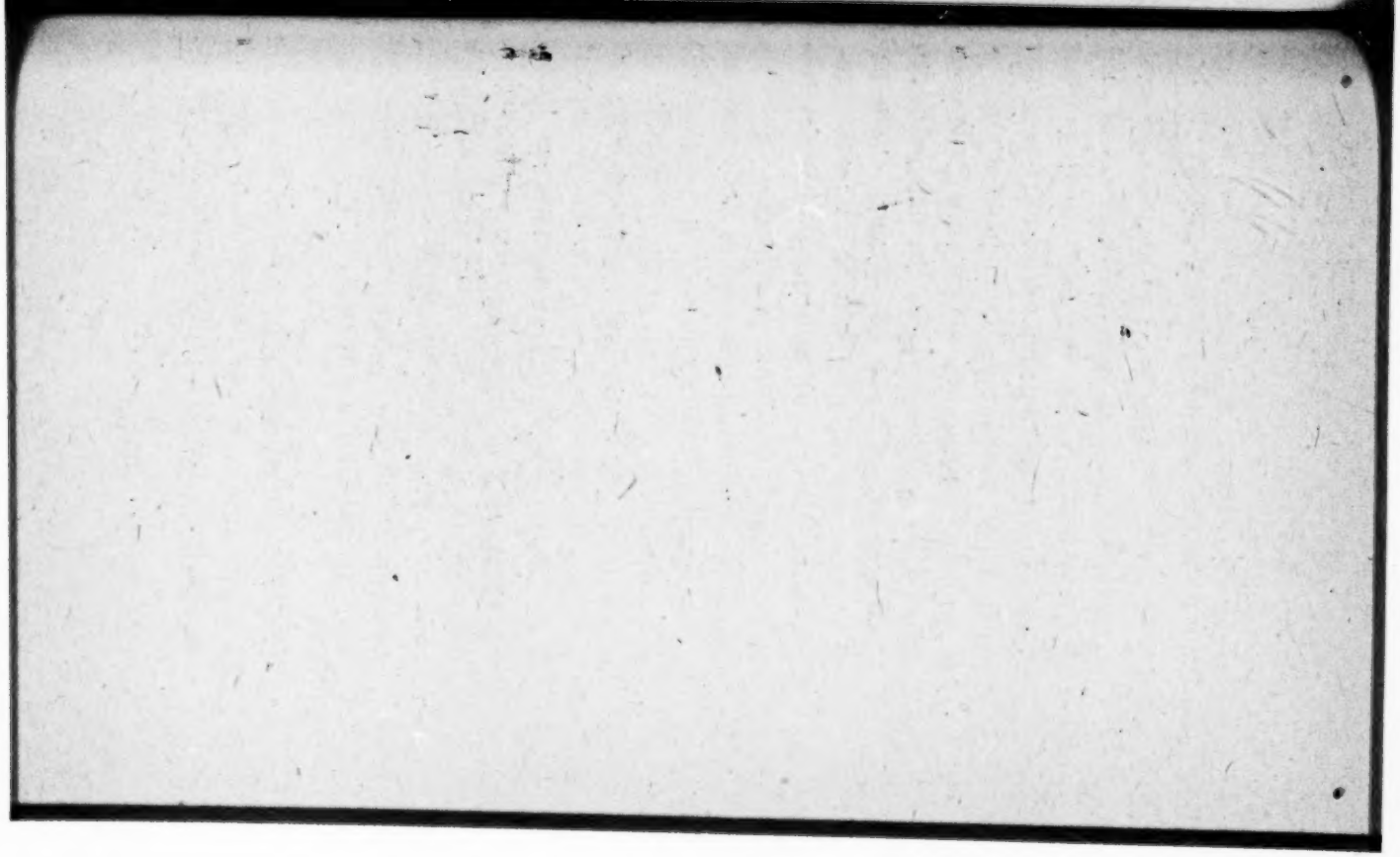
[2] In the *Harding Glass Co.* case the dissent shows that the court advisedly concluded that the doctrine of the *Dobson* case did not preclude judicial review.



CONCLUSION

The court below did not err in reviewing the decision of the Tax Court. Its conclusion was correct, and there is no conflict and no occasion for further review. The petition should therefore be denied.

Respectfully submitted.

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